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SUBJECT: BENZENE FUEL SUPPLY BOTTLENECK SQUEEZES MARKET

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SUMMARY

¶1. (SBU) The Government of Ethiopia's (GoE) decision to require regular benzene to be blended with ethanol has led to severe benzene fuel supply gaps, exacerbating an already inefficient fuel supply chain. The ethanol blending program has hampered the GoE's ability to maintain adequate benzene fuel supply to its fast growing urban centers, leaving private motorists and the public transportation sector to fight long lines and more often face empty pumps at fuel stations. The benzene fuel shortage appears to be affecting all sectors of the Ethiopian economy and more recently has put GoE officials on a collision course with the domestic fuel retailers and transnational oil company fuel suppliers. To date, diesel supply has not been affected. This latest fuel supply crisis provides yet another example of how state-oriented GoE economic policies continue to impede market stability and broader economic growth. END SUMMARY.

GOE POLICIES LEAVE PUMPS DRY

¶2. (SBU) In recent months, the GoE has enacted several fuel policy actions that have made regular benzene fuel supply problematic. First, the GoE's move to require transnational oil companies operating in Ethiopia to blend regular benzene fuel with five percent ethanol before delivery to the domestic retail market seems to have contributed to an acute supply gap. Motorists have been facing one to three hour traffic queues and barren fuel pumps at local fueling stations. The fuel blending directive, which was endorsed by the Council of Ministers in September 2007, authorized the Ministry of Trade and Industry (MOTI) to force all domestic fuel retailers and private transnational oil company suppliers to begin selling a fuel blend of 95 percent regular benzene and five percent Ethanol starting September 2008. In addition, the government as recently as November 21, 2008 threatened license seizures of all domestic fuel retailers found not to be adequately stocked with the new blended fuel. While the blending program is a cost savings initiative replacing five percent of the country's imported benzene bill with domestically produced Ethanol, the GoE's license seizure directive aims to break the loggerhead between the fuel retailers, transport companies and transnational oil company suppliers of blended fuel.

¶3. (SBU) According to the General Manager of Kobil, a Kenya based transnational oil company operating in Ethiopia, the GoE's recent directives further establish Ethiopia as having one of the most tightly regulated oil and fuel trading markets in the world. Over the last several years, the GoE has instituted fuel regulations such as: 1) strict price controls on the fuel and lubricant market by MOTI, 2) GoE regulation of fuel transportation logistics and costs,

3) GoE monopoly control of importation of all oil and fuel products, and 4) GoE oversight of fuel quality. In addition, the blending directive has largely resulted in general confusion among domestic fuel retailers concerning the roll-out and supply cost agreements with the transnational oil company fuel suppliers and government regulated fuel transport companies. Currently, the GoE imports all domestic fuel needs with its limited supply of hard foreign currency, allowing transnational oil companies to purchase the imported fuel in local currency (Ref A). Oil companies deliver, process, and sell the imported fuel products to a largely mom-and-pop domestic retail market that sells to the public under transnational oil company logos.

COST-SAVING ETHANOL PROGRAM INCREASES COSTS

¶4. (SBU) The ethanol blending fuel program which was implemented as a cost saving effort to reduce the GoE's soaring fuel bill has increased costs for retailers, suppliers and transporters of fuel. Retailers have alleged that they have observed measurable losses in fuel stock deliveries since the GoE directed oil companies to blend regular benzene fuel and ethanol before delivery to local retail depots. Fuel retailers and suppliers both blame the temperature differences between the government-designated blending facility in Salulta (20 km outside Addis Ababa) and the retail market in Addis Ababa as the culprit behind the perceived volume losses. Apparently, the volume of the blended liquid fuel expands in warming temperatures and contracts in cooler temperatures resulting in a perceived volume change. Neither retailers nor suppliers have been able to resolve this discrepancy. In addition, petroleum

transporters argue that the new urban supply route linking the blending facility in Salulta to the Addis Ababa leaves their trucks stuck in traffic most of the day and has significantly impacted their ability to remain profitable. Transporters of fuel have formally appealed to MOTI to enact a 300 percent wage increase (from USD 2.5 cents to USD 7.5 cents per km traveled) for their transport services to carry fuel to retailers.

FUEL RETAILERS SAY NO TO INCREASED COSTS

¶5. (SBU) Fuel retailers have formally protested the entire fuel blending program and for many weeks refused to accept regular delivery of benzene fuel from domestic oil companies since September ¶2008. Fuel retailers blame domestic oil company suppliers for not providing them with the requisite volume of fuel determined in purchase agreements. According to press accounts, the Dealers Association, who represents retailers, warned all concerned parties in a letter to MOTI, dated October 21, 2008, that they would not be able to operate their fuel retail facilities if they incurred losses due to perceived fuel stock degradation upon delivery. A local Total company fuel retailer explained to EconOff that retailers have the right to refuse fuel delivery if they believe any loss or unwarranted tampering of product has occurred. However, if loss due to volume contraction from temperature changes occurs, retailers would be forced to absorb the costs if they want to keep their stations stocked. Additionally, retailers who are already operating on a thin margin (USD 0.03 per cubic meter sold - set through government regulations) may face certain closure if they accept losses. The retailer operating under the Total Oil company brand estimates that his business would lose roughly one percent of his yearly purchases of benzene stock as a result of fuel stock loss at the time of delivery.

EASY TARGET: BIG OIL PROFITS SQUEEZED

¶6. (SBU) The transnational fuel suppliers seem to have gotten caught in the cross hairs of the recent GoE directive and fuel retailers' unwillingness and inability to realize losses in fuel stocks at delivery. According to Kobil Ethiopia's General Manager, most

transnational oil companies operating in Ethiopia have decided to absorb the costs associated with loss in fuel inventory coming to market from the blending facility in Salulta. Retailers cannot realize any additional squeeze on their limited profits of USD 0.03 per cubic meter of fuel sold. The Kobil representative explained to EconOff that oil companies in Ethiopia can earn roughly USD 5 per cubic meter of fuel sold compared to as much as USD 200 per cubic meter sold in neighboring Uganda. According to the Kobil representative, the additional costs resulting from fuel stock loss after blending will continue to peel away their already small margins and make operations unsustainable. Transnational oil companies have a choice to either continue absorbing the additional costs associated with this blending directive or worse consider the prospect of a complete pull out of the Ethiopian market. As recently as November 14, 2008, after 60 years of presence in the country, Royal Dutch Shell Oil Company pulled out of Ethiopia following the departure of Mobile and Agip oil companies, three and six years ago, respectively. Libya Oil Holding Ltd has assumed control of 100 percent of Shell's downstream oil products marketing business and its 142 employees in Ethiopia.

¶7. (SBU) To date, only the National Oil Company (NOC) fuel retailers have been able to provide a steady supply of blended benzene and ethanol fuel products to the local market. While there has been a visible shuttering of doors of the other oil companies and local fuel retailers, NOC has struggled to meet the soaring demand for benzene fuel. NOC retailers have battled to fight back the seemingly endless lines of cars at their area retail depots. It is to be noted that NOC is owned and managed by the Midroc Ethiopia Investment group. The Midroc group is run by Sheikh Mohammed al-Amoudi, the single largest private investor in Ethiopia. According to a rival fuel retailer, most NOC retailers have more financial flexibility at their disposal and credit facilities as a result of the parent oil company's close relationship with the GoE and Commercial Bank of Ethiopia. As recently as December 07, 2008, Ethiopian media outlets reported that NOC clinched two lucrative GoE contracts with a combined worth of USD 73 million. NOC defeated all other oil company bids to supply Ethiopian Roads Authority (ERA) with asphalt at a cost of USD 30 million and Ethiopian Electric Power Corporation (EEPCO) with diesel fuel at a cost of USD 42.8 million.

GOE BLAMES LOGISTICS AND AFFIRMS FUEL POLICY

¶8. (SBU) The GoE denies that there is a fuel supply shortfall in-country or any suggestion that its benzene and ethanol fuel blending program is the cause for the fuel shortage. Ato Yeshitla from MoTI's commercial office told EconOff that he believes that the problem is not related to an import gap or the ethanol blending program, but instead is related to resolvable logistical disagreements between the suppliers and retail companies. In addition, EPE points to congestion of the heavily used ports and roads network and the lack of transport capacity as major factors in exacerbating domestic fuel supply backlogs. The GoE is confident that the benzene supply shortage can be corrected with its recent policy directive, which forces a compromise between retailers and suppliers by threatening license seizures for non-compliant fueling stations. In a recent meeting at MOTI, an unnamed GoE official expressed disappointment at the fuel suppliers and retailers for not being able to resolve their dispute. According to an official from one of the transnational oil companies present in the meeting, the MOTI official pointed out that the government was providing the market a great service by importing all of the fuel and could not understand why suppliers and retailers were quibbling about pricing.

GOE SETS PRICES AND FUEL SUPPLY CHAIN

¶9. (SBU) The GoE uses a heavy hand in the management of fuel prices and the supply chain in Ethiopia. MOTI is authorized to adjust fuel

prices on a monthly basis to reflect exogenous and endogenous trends; however does not allow oil companies to capture additional profits from increased world oil prices (Ref B). The GoE also captures roughly 15 of the state-authorized 30 percent profit margins that oil companies could realize while selling lubricants. The lubricants business can be very lucrative and has in large part kept many retailers and suppliers in business in spite of razor thin margins on fuel sales. On the supply side, EPE imports the bulk of petroleum products from the Gulf countries with diesel accounting for 90 percent of the total import stock. Also, EPE imports roughly 80 percent of its required regular benzene from Sudan, with the balance coming from the Gulf market. The GoE also sets the transport costs and quality standards for imported fuel. EPE collects petroleum imports at the ports of Sudan and Djibouti where transnational oil companies prepare the product for delivery and blending just outside of Addis Ababa. To date, there has not been a slowdown in the volume of fuel and oil imports to Ethiopia. Ethiopia imported 1.88 million tons of fuel in 2007, at a cost of USD 1.55 billion, up 17 percent from the previous year. In 2008, EPE plans to import as much as 2.15 million tons of fuel.

¶10. (SBU) There are six oil companies operating in Ethiopia who are responsible for transporting the fuel coming from the ports to their depots in the country: 1) National Oil Company (NOC), 2) Libya Oil Holding Ltd, 3) Total, 4) Kobil, 5) Yetebaberut, and 6) Nile Petroleum Company. The oil companies are held responsible for any loss of fuel stock during the delivery and blending process. The transnational oil companies transport regular benzene to the blending center at Salulta, which is currently managed and operated by Sudan based Nile Petroleum Company. The Nile Petroleum Company is tasked by the GoE with blending the imported benzene with the required five percent Ethanol before fuel hits Addis Ababa and other local markets. The GoE is the monopoly supplier of ethanol to Nile Petroleum Enterprise, selling the product at a fixed price. Currently, the GoE's blending program uses about one third of its existing ethanol capacity. In the next 5 years, the GoE plans to increase ethanol production capacity fourfold to 130 million liters per annum at four domestic sugar factories in order to meet demands for its fuel blending program. According to the Ministry of Mines and Energy, although Fincha sugar factory is the only producer of Ethanol to date, Methara, Wonji, and Tendaho sugar factories will soon come on line.

COMMENT

¶11. (SBU) The GoE's statist fuel policies have complicated an already inefficient fuel market and have managed not to address the real benzene fuel supply bottleneck, which has pitted retailers, suppliers and transporters of fuel against one another. The GoE's November 21, 2008 move to pull the licenses of all non-compliant fuel retailers has gotten fuel flowing again, but at the expense of oil company margins. Although oil companies have acquiesced to the GoE's policy in the short-term, this latest action cannot indefinitely force retailers and transnational oil companies, who by their own admission are operating at a loss, to continue to do

business in Ethiopia if fuel policies do not change. Despite the steady flow of fuel from foreign suppliers, the GoE may be suffering from a crisis of confidence among domestic retailers, oil company suppliers and a public who cannot understand why pumps continue to run dry and why they continue to pay relatively the same price at the pump in spite of almost 60 percent declines in world oil prices. The current dispute may result in future benzene shortages, retail fuel hoarding among motorists and, worse, the departure of existing private transnational oil companies from Ethiopia. Post will continue to monitor the ongoing fuel crisis. END COMMENT.
Yamamoto